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Nos. 92-1384, 92-1839

In The

Supreme Court of the United States

October Term, 1993

BARCLAYS BANK PLC,

Petitioner,

v.

FRANCHISE TAX BOARD,

Respondent.

COLGATE-PALMOLIVE COMPANY,

Petitioner,

v.

FRANCHISE TAX BOARD,

Respondent.

On Writs Of Certiorari To The Court Of Appeal Of The State of California In And For The Third Appellate District

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF OF CALIFORNIA LEGISLATURE AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE

The California Legislature hereby respectfully moves for leave to file the attached brief amicus curiae in these cases. The consents of the attorneys for the respondent have been obtained. The consents of the attorneys for the petitioners were requested but refused.

The interest of the California Legislature in these cases arises from the fact that the California Legislature holds the express power to enact legislation to impose taxes upon corporations in the State of California pursuant to the California Constitution. Any limitation on the use of worldwide combined reporting to determine taxable income attributable to California would have the effect of circumscribing that power of the California Legislature. The brief of amicus curiae will set forth arguments relating to (1) the impact that the issues raised before the Court have upon the sovereign taxing power of California and (2) the efforts of the California Legislature to exercise the State's power to tax, with respect to corporations that are doing business in California and are engaged in a unitary business with foreign affiliated corporations, with due regard to California's budgetary constraints, with fairness to all affected taxpayers, and in deference to federal governmental concerns regarding the state's use of worldwide combined reporting.

The California Legislature believes that it can provide a different perspective to the Court in its examination of the issues presented, and that its arguments, if

accepted, would be dispositive of many of the issues presented in these cases.

Respectfully submitted,

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BRIEF OF CALIFORNIA LEGISLATURE AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

The California Legislature submits this brief, as amicus curiae, pursuant to Rule 37 of the Rules of the Supreme Court of the United States, in support of respondent.

INTEREST OF AMICUS CURIAE

The California Legislature holds the express power to impose taxes upon corporations in the State of California pursuant to the California Constitution. Any limitation on the use of worldwide combined reporting to determine taxable income attributable to California would have the effect of circumscribing that power of the California Legislature. This brief will demonstrate (1) the impact that the issues raised before the court have upon the sovereign taxing power of the California Legislature and (2) the efforts of the California Legislature to exercise this power, with respect to corporations that are doing business in California and are engaged in a unitary business with foreign affiliated corporations, with due regard to California's budgetary constraints, with fairness to all affected taxpayers, and in deference to federal governmental concerns regarding the state's use of worldwide combined reporting.

SUMMARY OF ARGUMENT

The Tenth Amendment to the United States Constitution guards against undue federal interference with certain core state functions. No function of state government is more essential to its sovereignty than the administration and collection of taxes. California has enacted a fairly apportioned, nondiscriminatory corporate franchise tax that is applied equally to all unitary businesses. The apportionment formula used to calculate the state tax results in a determination of the amount of income that is fairly attributable to the business activities in California of a unitary business, regardless of where the balance of the unitary business may be located.

The imposition of this fairly apportioned, nondiscriminatory tax by California on corporations doing business in California does not impair federal rights to regulate foreign commerce or impact upon the federal government's ability to speak with "one voice" with regard to foreign affairs. The Congress of the United States alone holds the power to regulate commerce with foreign nations. The President of the United States holds the power to make treaties with the advice and consent of the United States Senate. However, the Congress has deliberately and repeatedly refused to prohibit the use by the States of worldwide combined reporting as a means of determining the tax liability of unitary businesses with both foreign and domestic commercial activities. In addition, no treaty has been made by the President that would prohibit the use of worldwide combined reporting in connection with the state taxation of those unitary businesses.

Finally, the California Legislature has consistently identified the concerns of the federal government and the domestic and international business communities with regard to California's use of worldwide combined reporting and has revised and recast California's corporate franchise tax law in a conscientious effort to address those concerns.

ARGUMENT

I. THE POWER TO TAX IS AN INHERENT RIGHT OF THE STATE OF CALIFORNIA AND ITS EXERCISE MAY NOT BE LIMITED BY MERE IMPLICATION; NO FEDERAL CONSTITUTIONAL PROVISION PROHIBITS THE USE OF WORLDWIDE COMBINED REPORTING, THUS, THE EXERCISE HERE OF THE SOVEREIGN RIGHT OF CALIFORNIA TO TAX IS PROPER

A. The Tenth Amendment Ensures California's Sovereignty, Thereby Creating a Dual System of Sovereignty Between California and the Federal Government Under Which Neither Entity May Impair the Sovereignty of the Other

The Tenth Amendment to the United States Constitution provides that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people." The thrust of this constitutional provision is that the States are not mere political subdivisions of the United States. Instead, the several States retain a residuary and inviolable sovereignty. *New York v. United States*, 505 U.S. ___, 120 L. Ed. 2d 120, 158 (1992). In recognition

of this sovereignty, the Constitution confers upon Congress the power to regulate individuals, not States. Consequently, although Congress is granted the power to regulate commerce, it lacks the power to directly compel the States to regulate commerce. *Id.*, 120 L. Ed. 2d at p. 144.

As this Court recently recognized, "[t]he States retain substantial sovereign authority under our constitutional system." *Gregory v. Ashcroft*, 501 U.S. ___, 115 L. Ed. 2d 410, 422 (1991). Although Congress may legislate in areas traditionally regulated by the states pursuant to the Supremacy Clause, Congress does not exercise that power lightly. "[O]ur Constitution establishes a system of dual sovereignty between the States and the Federal Government," *Id.* (115 L. Ed. 2d 410, 421), for it is "founded upon the total or partial incorporation of a number of distinct sovereignties." Alexander Hamilton, *The Federalist No. 82*, p. 458 (I. Kramnick ed., 1987). "[T]he Court's consistent understanding" is that " '[t]he States unquestionably do retai[n] a significant measure of sovereign authority . . . to the extent that the Constitution has not divested them of their original powers and transferred those powers to the Federal Government.' " *New York v. United States*, 505 U.S. ___, 120 L. Ed. 2d 120, 137 (1992), quoting *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 549, 83 L. Ed. 2d 1016, 1033 (1985). Almost 70 years ago, this Court discussed the tension between state and federal taxing powers as follows:

> "[N]either government may destroy the other nor curtail in any substantial manner the exercise of its powers. Hence, the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax (*South Carolina v. United States*, 199 U. S. 437, 461, 50 L. ed. 261, 269, 26 Sup. Ct. Rep. 110, 4 Ann. Cas. 737; *Flint v. Stone Tracy Co.* 220 U. S. 172, 55 L. ed. 421, 31 Sup. Ct. Rep. 342, Ann. Cas. 1912B, 1312) or the appropriate exercise of the functions of the government affected by it (*Union P. R. Co. v. Peniston*, 18 Wall. 31, 21 L. ed. 791)." *Metcalf & Eddy v. Mitchell*, 269 U.S. 514, 523, 70 L. Ed. 384, 392 (1926).

In *EEOC v. Wyoming*, 460 U.S. 226, 75 L. Ed. 2d 18 (1983), this Court (in both its majority and dissenting opinions) reaffirmed the importance and vitality of constitutional principles of federalism in analyzing Congress's exercise of its powers under the Commerce Clause. The majority in that case, speaking through Justice Brennan, concluded that the principles of federalism embodied in the Tenth Amendment did not bar application of the Age Discrimination in Employment Act of 1967 to a State's game wardens. The Court nevertheless emphasized that the Tenth Amendment guards against "undue federal interference in certain core state functions" and ensures the "unique benefits of a federal system in which States enjoy a 'separate and independent existence.' " *Id.*, 460 U.S. at p. 236, quoting, in part, *Lane County v. Oregon*, 74 U.S. (7 Wall.) 71, 76, 19 L. Ed. 101, 104 (1869).

B. The Power to Tax is at the Core of California's Sovereignty and May Not be Interfered With by the Federal Government in the Absence of a Direct and Substantial Interference With a Federal Power

The power to tax is essential to the very existence of state government and may be exercised to the utmost

extent, limited only by the structure of the government itself. *M'Culloch v. The State of Maryland et al.*, 17 U.S. (4 Wheat.) 316, 428, 4 L. Ed. 579, 607 (1819). The power to tax is not confined to the people or property of a State, but may be exercised with respect to every object brought within a State's jurisdiction. *Id.*, 17 U.S. (4 Wheat.) at p. 429; *Harvester Co. v. Dept. of Taxation*, 322 U.S. 435, 444-45, 88 L. Ed. 1373, 1381 (1944).

Thus, no function of state government goes more to the core of its sovereignty than the power to tax. See, e.g., *Bode v. Barrett*, 344 U.S. 583, 585, 97 L. Ed. 567, 571 (1953). Federal interference with that function, whether by the courts or Congress, has limitless potential to disrupt the operation of state governments.[1] Accordingly, this Court has long recognized "the important and sensitive nature of state tax systems and the need for federal-court restraint when deciding cases that affect such systems." *Fair Assessment in Real Estate Assn. v. McNary*, 454 U.S.

[1] If this Court retroactively prohibits the use of worldwide combined reporting, as urged by petitioners, it is estimated that the State of California will lose $4.0 billion in revenue. That amount represents disputed taxes collected or collectable over the past three decades. However, if the disputed taxes are refunded in a single year as a result of a decision adverse to respondent, they would represent approximately 8 percent of the State's 1993-94 annual state budget of $52.1 billion. Ch. 55, Cal. Stats. 1993. Since 1977, the last tax year (income year) at issue here, the State of California has experienced deficits in 12 of the succeeding 16 years. California Legislative Analyst's Office *CAL Facts* (May 1993), p. 29 [Appendix A]. As a result of these shortfalls in revenue, the loss of 8 percent of the state budget would seriously threaten California's fiscal stability and would force further budget reductions in essential public services.

100, 102, 70 L. Ed. 2d 271, 274 (1981); see also *United States v. California*, 507 U.S. ___, 123 L. Ed. 2d 528 (1993); *Great Lakes Co. v. Huffman*, 319 U.S. 293, 87 L. Ed. 1407 (1943); *Mathews v. Rodgers*, 284 U.S. 521, 76 L. Ed. 447 (1932); *First Natl. Bank v. Weld County*, 264 U.S. 450, 68 L. Ed. 784 (1924). Over a century ago in *Dows v. City of Chicago*, 78 U.S. (11 Wall.) 108, 20 L. Ed. 65 (1871), this Court was confronted with a question of whether a State should be enjoined from collection of a tax even if it is conceded that the tax is illegal. In exercising judicial restraint by denying equitable relief, this Court stated:

> "It is upon taxation that the several States chiefly rely to obtain the means to carry on their respective governments, and it is of the utmost importance to all of them that the modes adopted to enforce the taxes levied should be interfered with as little as possible. Any delay in proceedings of the officers, upon whom the duty is devolved of collecting taxes, may derange the operations of government, and thereby cause serious detriment to the public." *Dows v. City of Chicago*, 78 U.S. (11 Wall.) 108, 110, 20 L. Ed. 65, 66 (1871).

A State's power to tax is not derived from the Constitution of the United States, but exists independently therefrom. *Railroad Company v. Peniston*, 85 U.S. (18 Wall.) 5, 29, 21 L. Ed. 787, 791 (1873). The sole constitutional provision restricting the State's power to impose taxes is the general prohibition upon the laying of imposts or duties on imports or exports. U.S. Const., Art. I, Sec. 10; *Railroad Company v. Peniston*, supra, 85 U.S. (18 Wall.) at p. 29. Neither petitioner claims that this constitutional provision is implicated here.

Although a State may not levy taxes that directly hinder the exercise of any power that belongs to the federal government, a state tax that only remotely affects the efficient exercise of a federal power is, for that reason alone, not prohibited by the Constitution. *Id.*, 85 U.S. (18 Wall.) at p. 30. Thus, unless it is clearly shown that there is some particular, direct, and substantial, and not merely an incidental or gratuitous, interference with a federal right, a State, is free to exercise its taxing power. *Shannon v. Streckfus Steamers*, 279 Ky. 649, ___, 131 S.W. 2d 833, 838 (1939). Moreover, a State's power to tax may not lightly be stricken down on the basis of mere implication. *Great Lakes Dredge & Dock Co. v. Charlet*, 134 F. 2d 213, 216 (5th Cir., 1943), affd. *Great Lakes Co. v. Huffman*, 319 U.S. 293, 87 L. Ed. 1407 (1943).

Section 27 of Article XIII of the California Constitution expressly permits the California Legislature to "tax corporations, including State and national banks, and their franchises by any method not prohibited by this Constitution or the Constitution or laws of the United States." Accordingly, in the absence of a direct and substantial interference with a federal power, the State's power to tax cannot be circumscribed by the federal government.

Petitioner Barclays Bank PLC ("Barclays") asserts that there is international objection to the use of worldwide combined reporting. Brief for Petitioner Barclays, at pp. 6-7. However, the national policy established by the Congress and the federal Executive clearly permitted the use of worldwide combined reporting during the tax years (income years) in dispute. See Argument III B, infra, at pp. 19-24. Thus, the assertion of Barclays does

not establish a direct and substantial interference with any federal power and, consequently, the power of the California Legislature to impose taxes in the manner at issue here may not be limited.

C. If Congress Perceives that California's Exercise of Its Power to Tax is Impinging upon Congressional Power to Regulate Foreign Commerce, then Congress Is the Proper Body to Limit California's Power to Tax

Rather than this Court imposing judicially constructed restraints on the power of States to impose taxes, Congress is in the best position to act to restrict or curtail state powers to tax based on any perceived intrusion into Congress' power with respect to foreign commerce. However, in the period of a decade and a half since Barclays filed its return for the tax year at issue, Congress has deliberately chosen not to limit the State's power to use worldwide combined reporting despite the introduction of various federal legislative proposals to limit that power. See discussion in Argument III A, infra, at pp. 18-19.

II. THE TAX IMPOSED BY CALIFORNIA ON CORPORATIONS THAT DO BUSINESS IN THE STATE, INCLUDING CORPORATIONS WITH FOREIGN AFFILIATES, IS FAIRLY APPORTIONED AND NOT DISCRIMINATORY

Formulary apportionment has been approved for more than a century as a means of fairly dividing a single tax burden among several jurisdictions in which a taxpayer does business. See *State Railroad Tax Cases*, 92 U.S. 575, 23 L. Ed.

663 (1875). The Constitution imposes no single formula on the States. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 164, 77 L. Ed. 2d 545, 552 (1983). California's three-factor formula of property, payroll, and sales was approved by this Court over a half century ago, *Butler Bros. v. McColgan*, 315 U.S. 501, 86 L. Ed. 991 (1942), and has become a benchmark against which other apportionment formulas are measured. *Trinova Corp. v. Michigan Dept. of Treasury*, 498 U.S. 358, 380-381, 112 L. Ed. 2d 884, 909 (1991), citing *Container Corp. v. Franchise Tax Bd.*, supra, at p. 170; see *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 284, 57 L. Ed. 2d 197, 210 (Blackmun, J., dissenting) (1978).

Petitioners do not make any claim before this Court that the tax imposed on them using formulary apportionment is not a fairly apportioned tax. Petitioners primarily object to the mechanical means of determining their tax: worldwide combined reporting. Specifically, petitioners assert that multinational corporations are entitled to determine their tax in a manner different from wholly domestic unitary enterprises doing business in California because petitioners are each a part of a unitary business that has a structure that includes a foreign affiliate.

The essence of Barclays' assertions is that it should be treated differently because one of its foreign affiliates is the parent corporation, Brief for Petitioner Barclays, at p. 3. However, a differential means of taxation based on whether a corporation has a foreign or domestic domicile would violate the foreign commerce clause. See *Kraft Foods v. Iowa Dept. of Rev.*, 505 U.S. ___, 120 L. Ed. 2d 59, 67 (1992). Moreover, the exploitation by foreign corporations of intrastate opportunities under the protection and encouragement of local government offers a basis for taxation as unrestricted as that for domestic corporations. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623, 69 L. Ed.

2d 884, 898 (1981). This Court has made clear that the Commerce Clause does not relieve foreign corporations from paying their just share of the state tax burden even though it increases the cost of doing business, because to do so would be to place those corporations in a privileged position. *Id.*, 453 U.S. at pp. 623-624.

Petitioner Colgate-Palmolive Company ("Colgate") makes a similar claim based on the inclusion of its foreign subsidiary corporations, Brief of Petitioner Colgate, at p. 47, even though this Court has previously rejected an identical claim. Specifically, this Court has previously concluded that California's application of the unitary business principle and the three-factor formula to a domestic corporation with overseas subsidiaries was proper and not unconstitutional. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 184, 77 L. Ed. 2d 545, 565 (1983). More importantly, this Court took note of, and approved, the worldwide combined reporting method used to determine the tax owed by the unitary group in that case. *Id.*, 463 U.S. at pp. 174-175.

Even though Barclays claims that the method of taxation imposes a discriminatory compliance burden, the California Court of Appeal found that the compliance burden was not unconstitutional because California required the same information from all taxpayers. *Barclays Bank Internat. Ltd. v. Franchise Tax Bd.*, 10 Cal. App. 4th 1742, 1753-1756. Under the method employed in California, the amount of tax owed is the same regardless of whether the parent corporation of a group of corporations that operate as a unitary business is located in California, in another State, or in a foreign country. See Cal. Rev. & Tax. Code Sec. 25101. The tax calculation is

neutral in that respect, and clearly nondiscriminatory. The location of the parent corporation is irrelevant to the tax calculation and has no bearing upon what records are required or must be maintained in order for that portion of the unitary business that does business in California to file a tax return or combined report in California. The only information a taxpayer needs with regard to its unitary business is a record of its business income, property, payroll, and sales. Cal. Rev. & Tax. Code Sec. 25128.

Each corporation that does business in California is required to file a tax return. Cal. Rev. & Tax. Code Sec. 25401. In addition, corporations doing business in California that are part of a unitary business are required to file a combined report. Cal. Rev. & Tax. Code Sec. 25101.

The problem inherent in taxing a multinational unitary business is that there is a single worldwide business, and in some fashion a jurisdiction, such as California, must fairly apportion the business income of that unitary business to the jurisdiction in order to determine a tax upon that income. Petitioners do not claim that either of them is other than a part of a unitary business. The existence of a unitary business indicates that there are economies of scale and transfers of value among the affiliated corporations. See *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 166, 77 L. Ed. 2d 545, 554 (1983).

To determine a fair tax, California must determine what portion of business activity is fairly attributable to California. Implicitly, where there is a unitary business there is some single entity that is a part of that business that has a record of the value of the whole business. Under the method employed in California, the tax rate is

applied to that portion of the net income that is attributable to the business in California. The amount of business activity attributable to California is measured by determining the proportion that the property, payroll, and sales in the State of the unitary business bears to the total of the property, payroll, and sales everywhere of the unitary business. Cal. Rev. & Tax. Code Sec. 25128.

Thus, as the calculation is applied to any unitary business that does business within the State of California, the calculation is blind as to where the parent corporation of the group is located.[2] The parent corporation may be located in California, elsewhere in the United States, or in another country. As among the members of the unitary group, it is immaterial who maintains sufficient data to make the calculation of business activity attributable to the State of California, and it is immaterial where that data is maintained. It is sufficient that the tax records of the unitary business are maintained by some member of the group, whether it be a subsidiary located in California, a subsidiary located elsewhere, a parent corporation located in California, or a parent corporation located anywhere in the world.

Moreover, use of the California three-factor formula is well-established, *Butler Bros. v. McColgan*, 315 U.S. 501, 509, 86 L. Ed. 991, 997 (1942), and does not result in a

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[2] In fact, the parent corporation may not even be a part of the unitary business. There may well be examples of unitary groups in which there is no integration between the parent corporation and the unitary business that does business in California. In that instance, the formula would exclude any factors, or value, of the parent corporation from the calculation of the tax.

"novel state tax" that carries a risk of asymmetry in the international tax structure. See *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 194-195, 77 L. Ed. 2d 545, 572 (1983). Although Barclays asserts that automatic asymmetry results, Brief for Petitioner Barclays, at pp. 28-29, that is clearly not the case. Using the three-factor formula as a means of apportioning business income, a foreign multinational that has the same portion of its business activity in California as a domestic multinational will pay the same tax.

Petitioners seek to circumscribe a method of fairly apportioning taxes that has been successfully used by states for over a century. Barclays bases its rationale upon an assertion that the foreign parent corporation within its unitary business objects to the imposition of a fairly apportioned tax upon corporations that do business within the State of California. Brief for Petitioner Barclays at pp. 11-12. The implication of that assertion is that a unitary business that does business in California ought to be accorded special treatment if the unitary business has a parent corporation that is located in a foreign country.[3]

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[3] It is clear that domestic subsidiary corporations of a foreign parent corporation are not entitled to any special treatment under a treaty with the national government of the foreign parent. *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 188-189, 72 L. Ed. 2d 765, 774-775 (1982). The logical corollary to this holding is that in absence of an express treaty provision both foreign and domestic corporations doing business in a jurisdiction within this country should be treated alike. In accordance with this principle, California applies the same formulary apportionment method to all unitary businesses regardless of the place of their incorporation.

The California Legislature believes that its power ought not to be curtailed where it has merely imposed a tax on activity within the borders of the State of California. The imposition of a tax on discrete activity in California of corporations doing business within the state does not, in and of itself, implicate foreign affairs. The controversy arises in this case from the methodology used to measure California activity that takes into consideration worldwide activity in order to derive a measure of activity within California. The mere fact that this controversy may have arisen in an international context because a multinational corporation objects to the particular method that California and other States in this nation use to apportion income to each State does not, by itself, establish that the method impinges on the exclusive federal power concerning the conduct of foreign affairs.

The State of California, acting through its Legislature, has a sovereign right to impose nondiscriminatory, fairly apportioned taxes on corporations doing business within the State's borders. No federal constitutional provision prohibits the use of worldwide combined reporting. Thus, the exercise here of the sovereign right of California to tax is proper. Corporations that engage in business in more than one jurisdiction are not immune from paying a fair state tax. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 277, 51 L. Ed. 2d 326, 330 (1977). Accordingly, the California Legislature should continue to be permitted to impose fairly apportioned and nondiscriminatory taxes on any unitary business that does business in California without regard to where outside of California the affiliated corporations of the unitary business are located.

III. CALIFORNIA'S APPLICATION OF WORLDWIDE COMBINED REPORTING TO PETITIONERS WITH RESPECT TO THE TAX YEARS AT ISSUE DID NOT PREVENT THE FEDERAL GOVERNMENT FROM SPEAKING WITH ONE VOICE WHEN REGULATING RELATIONS WITH FOREIGN GOVERNMENTS; RATHER, THE EFFORTS OF THE CALIFORNIA LEGISLATURE IN ENACTING LAWS RELATING TO WORLDWIDE COMBINED REPORTING HAVE BEEN ENTIRELY CONSISTENT WITH FEDERAL POLICY AND HAVE ADDRESSED SPECIFIC CONCERNS RAISED BY THE FEDERAL GOVERNMENT AND MULTINATIONAL CORPORATIONS

In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 51 L. Ed. 2d 326 (1977), this Court adopted a four-part test to determine whether a state tax is valid against a Commerce Clause challenge: specifically, the tax must be applied to an activity with a substantial nexus with the taxing State; it must be fairly apportioned; it must not discriminate against interstate commerce; and it must be fairly related to the services provided by the State. *Id.*, 430 U.S. at p. 279.

When foreign commerce is at issue, this Court has held that, in addition to the four-part test, the tax must not create a substantial risk of international multiple taxation, and it must not prevent the federal government from speaking with one voice when regulating relations with foreign governments. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 450, 60 L. Ed. 2d 336, 349. This Court has held that a state tax at variance with federal policy will violate the "one voice" standard if it either implicates foreign policy issues which must be left to the

federal government or violates a clear federal directive. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 194, 77 L. Ed. 2d 545, 571-572 (1983). In that case, this Court decided that if a state tax merely has foreign resonances, but does not implicate foreign affairs, the Court cannot infer, absent some explicit directive from Congress, that treatment of foreign income at the federal level mandates identical treatment by the States. *Id.*, 463 U.S. at p. 571.

Barclays asserts that worldwide combined reporting undeniably implicates foreign policy issues which must be left to the federal government and prevents the nation from speaking with one voice. Brief for Petitioner Barclays, at p. 22. Barclays has previously asserted, both in the Supreme Court of California below and in its Petition for a Writ of Certiorari, that respondent's application of formula apportionment to the unitary business of which it is a part offends the foreign Commerce Clause because it violates a clear federal directive that is embodied in an array of federal Executive communications. *Barclays Bank Internat., Ltd. v. Franchise Tax Bd.*, 2 Cal. 4th 708, 726 (1992); Petition for Writ of Certiorari by Petitioner Barclays, at pp. 17 to 20, incl. Barclays now asserts in its opening brief that the use of a method of state taxation other than the arm's length method frustrates United States policy, and that the use of worldwide combined reporting results in the clearest foreign policy implication, namely, the risk of foreign retaliation. Brief for Petitioner Barclays, at pp. 22, 25. Colgate makes similar assertions. Brief of Petitioner Colgate, at pp. 6, 16, 17, 32 to 36, incl.

Petitioners' assertions ignore, among other things, that Congress has deliberately and repeatedly refused to enact a prohibition on the use of worldwide combined reporting by the States, and that the California Legislature has undertaken conscientious efforts to respond to the concerns of both the federal government and multinational corporations in connection with the State's modification of worldwide combined reporting. Moreover, petitioners' assertions are not consistent with the constitutional grant of authority provided by the Commerce Clause and misconstrue what the federal policy was during the tax years at issue in these cases.

A. Congress has Deliberately and Repeatedly Refused to Prohibit the Use of Worldwide Combined Reporting by the States

In 1978, the United States Senate specifically rejected article 9(4), as originally negotiated, in a bilateral tax treaty with the United Kingdom that would have disallowed worldwide combined reporting by the States. See Remarks of Senators Cranston, Javits, and Pell, 124 Cong. Rec. 18400, 19076 (1978). Significantly, this treaty was ratified by the United States Senate only after that provision was removed. *Ibid.* These facts, along with Congressional rejections of a number of federal legislative proposals with similar prohibitory provisions, were best summarized by the Supreme Court of California below, as follows:

> "The Senate's action with respect to article 9(4) is only the most explicit example of a persistent congressional refusal to enact curbs on the states' use of worldwide formula apportionment reaching back well before 1977, the tax year at issue in this case. The parties agreed in a pretrial stipulation that 'various proposed Legislative bills have been introduced in the United States Congress that would, among other things, affect the states' use of worldwide combined reporting.' The stipulation identifies twenty such House and Senate bills spanning twenty years. These range from House Resolution No. 11798 introduced in the House in 1965 (an ambitious 'Interstate Taxation Act' that would have required the states to adopt a two-factor apportionment formula in taxing unitary groups) to 1985 legislation sponsored by the Treasury Department that would have limited state use of worldwide formula apportionment to members of foreign-based corporate groups actually doing business in the United States, that is, so-called 'water's edge' legislation. (See *post*, pp. 739-740.) None of these measures was enacted into law by Congress." *Barclays Bank Internat., Ltd. v. Franchise Tax Bd.*, 2 Cal. 4th 708, 736 (1992).

B. The California Legislature has Responded Appropriately to the Concerns of both the Federal Government and Multinational Corporations

In 1983, shortly after this Court's decision in *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 77 L. Ed. 2d 545 (1983), the federal government announced plans to establish a working group composed of representatives of the federal government, state governments, and the business community to produce recommendations "that will

be conducive to harmonious international economic relations, while also respecting the fiscal rights and privileges of the individual states." Chairman's Report and Supplemental Views, Final Report of the Worldwide Unitary Taxation Working Group (Aug. 1984), Office of the Secretary, Department of the Treasury.

The final report of the working group, released in 1984, made recommendations for the states to mitigate the international effects of formula apportionment, including limiting its use to the "water's edge" (whereby certain affiliated entities of a unitary group are excluded from the unitary tax base). *Id.*, at p. iii.

The report stated that if states enact legislation based on the three principles agreed upon by the Working Group ((1) water's edge unitary combination for both U.S. and foreign based companies, (2) increased federal administrative assistance and cooperation with the States to promote full taxpayer disclosure and accountability, and (3) competitive balance for U.S. multinationals, foreign multinationals, and purely domestic businesses), the United States will be able to speak with one voice in dealing with its foreign trading partners. *Ibid.*

In response to the recommendations of the Chairman's Report, the California Legislature in 1986 enacted Senate Bill No. 85 (Ch. 660, Cal. Stats. 1986), which authorized a water's edge election for tax years beginning on or after January 1, 1988.[4] Specifically, S.B. 85 allowed a

[4] Thus, the assertion by one of amicus curiae supporting petitioners, that California currently uses "forced" worldwide combined reporting, is flatly wrong. See Brief of the Committee

qualified taxpayer, as defined, whose income is subject to the California franchise tax to determine its income derived from or attributable to sources within California pursuant to a water's edge election upon the payment of a specified election fee. Under this election, only the income and apportionment factors of certain affiliated entities (generally those located within the boundaries of the United States) would be included in the unitary tax base.

As the result, in part, of California's enactment of S.B. 85, the Honorable J. Roger Mentz, Assistant Secretary (Tax Policy) of the Department of the Treasury stated as follows:

> "I am pleased to report that, since the introduction of the legislation, Idaho, New Hampshire, Utah and, on September 5, California, have enacted "water's edge" legislation. The Administration applauds these states' actions. *These state legislative developments go a long way toward resolving the difficult unitary tax issue. Moreover, they illustrate the successful operation of the Federal system.* These and the other states that have moved away from the worldwide unitary tax system in recent years recognize that their interest, and the national interest, lies in a single, coherent approach to taxing international income that minimizes tax-related impediments to international flows of investment capital.
>
> "We have not, however, reached the end of the road with respect to this issue. Though the

on State Taxation as Amicus Curiae in Support of Petitioners, pp. 3, 4, and 7-10, incl.

economic impact is not great, three states (Alaska, Montana, and North Dakota) continue to impose tax on a worldwide unitary basis. As I will discuss below, we also have concerns regarding elements of the California legislation. *We believe, however, that such significant progress has been made that restrictive Federal legislation is not warranted at this time. . . .* California has an opportunity to consider and respond to comments on its recently enacted legislation, and we have an opportunity to evaluate the actual operation of water's edge legislation passed by the several states when fully in effect.

* * *

" . . . States have moved away from the worldwide unitary method in part in reliance on the Administration's representations in this regard. To the extent possible without legislation, the Administration has already moved to provide greater assistance to the states. We continue to be committed to providing such federal support. . . .

"The progress made on this difficult issue is a tribute to the wisdom of President Reagan's decision in 1983 to seek a cooperative solution by convening a Worldwide Unitary Taxation Working Group, consisting of representatives from states, business and the Federal government, to address the issue. It is also a tribute to the leadership evidenced by the state officials and leaders of domestic and foreign-controlled multinationals that have together forged compromises in states across the country. We expect that these participants will continue to demonstrate the same leadership as we attempt to address the remaining concerns relating to the worldwide unitary tax issue." Letter from J. Roger Mentz, Assistant Secretary of the Treasury (Tax Policy) to George Deukmejian, Governor of California (April 8, 1987) (J.A. 24-27). Emphasis added.

Moreover, contrary to petitioners' assertions that California's method of taxation leads to justifiable foreign retaliation, see Brief for Petitioner Barclays, at p. 28, the evidence indicates that the business community, including foreign corporations (and specifically Barclays), contributed significantly to both the legislative process that produced the enactment of S.B. 85 and the regulatory process thereafter that implemented that legislation and, generally, received substantial unitary reform as a result of the legislative compromise that was forged. See Appendix B.

In 1993, as a part of the continuing dialogue between federal and California officials and the business community, the California Legislature enacted Senate Bill No. 671 (Ch. 881, Cal. Stats. 1993) to make substantial changes to the water's edge provisions, including, among other things, the elimination of the requirement that an election fee be paid and the authorization of a taxpayer to elect to account for and determine its income pursuant to a water's edge election for an 84-month period. S.B. 671 also deleted the previous requirement of filing a domestic disclosure spreadsheet and, instead, provided that each taxpayer required to apportion its income was to file an annual information return, as specified.[5]

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[5] It should be noted that the voluntary actions of the California Legislature in enacting water's edge legislation have come at times when the State has been facing multi-billion

Again, as in the case of S.B. 85, the California Legislature was responsive to the concerns of both the federal government and the business community, and vitually all of the unitary reforms that had been sought were enacted. See Appendix C.

Thus, it is apparent that over the years the California Legislature has exercised its sovereign power to tax with due recognition and responsible consideration of the concerns and desires of both the federal government and the business community with regard to California's use of worldwide combined reporting. At the same time, the federal government has respected the use of worldwide combined reporting by individual states in the exercise of their sovereign taxing power and, in response to complaints from multinational corporations, has instituted and adhered to a policy that requested only voluntary state action in adopting water's edge legislation.

C. Petitioners' Heavy Reliance on Federal Executive Communications as Constituting a Clear Federal Directive for Purposes of the Commerce Clause is Misplaced

The Commerce Clause of the Constitution of the United States grants the power to Congress, not the

dollar budget deficits. For example, in 1993 the California Legislature was facing a budget deficit of over $7 billion. Nevertheless, even though future revenue collections were and remain uncertain (as of the time of this writing, a deficit of over $3.8 billion is projected for 1994), the California Legislature made the difficult choices of cutting vital programs and raising various other taxes, while still enacting S.B. 671.

Executive Department, to regulate foreign and interstate commerce. U.S. Const., Art. I, Sec. 8, cl. 3. Therefore, any action of Congress with respect to foreign commerce is certainly more determinative of federal policy in that regard than any desire or aspiration that may be expressed by individual representatives of the federal Executive. See *U.S. v. Curtiss-Wright Export Corp.*, 299 U.S. 304, 81 L. Ed. 255 (1936); *United States v. Guy W. Capps, Inc.*, 204 F. 2d 655, 658-660 (4th Cir. 1953), aff'd on other grounds, 348 U.S. 296, 99 L. Ed. 29 (1955).

Barclays' misplaced reliance on federal Executive communications as determinative of federal policy is also demonstrated in its criticism of the decision of the Supreme Court of California below, as follows:

> "The 'one voice' test proceeds from the strong presumption of the need for federal uniformity in the area of foreign commerce. *Japan Line*, 441 U.S. 434; *Wardair*, 477 U.S. 1. The decision of the court below sees no need for uniformity. Rather it invites state interference in foreign affairs unless Congress curbs the state. The California court would silence the Executive and in the silence of Congress permit a cacophony of state voices. Who can tell our foreign trading partners what the policy of the United States is? Can our foreign trading partners rely upon the responses of the Executive? Is this not exactly the situation which will lead to retaliation and harm to the nation as whole?" Petition for Writ of Certiorari by Petitioner Barclays, at p. 24. Footnote omitted.

Barclays' questions can be answered, in part, by posing the following question: Under our federal constitutional system, does the Executive Department have the authority to either enact a statute that would ban the use

of worldwide combined reporting by the States without Congressional approval, or to make a treaty that would ban the use of worldwide combined reporting by the states without obtaining the advice and consent of, and the concurrence of two-thirds of the membership of, the Senate? The answer obviously is no.

Even if it is conceded that the federal Executive has some measure of authority in this area, the federal Executive in fact has chosen only to request voluntary action by the States in enacting water's edge legislation to address the concerns expressed by some members of the business community. See, e.g., Chairman's Report and Supplemental Views, Final Report of the Worldwide Unitary Taxation Working Group (Aug. 1984), Office of the Secretary, Department of the Treasury; Letter from J. Roger Mentz, Assistant Secretary of the Treasury (Tax Policy) to George Deukmejian, Governor of California (April 8, 1987) J.A. 24-27.

D. Petitioners' Assertion That Worldwide Combined Reporting is Prohibited by Dormant Commerce Clause Analysis is Incorrect

Barclays sets out a number of events, most of which are subsequent to the enactment of Senate Bill No. 85 in 1986, and many of which occurred as recently as 1993, that disclose dissatisfaction or risk of retaliation by foreign governments. Brief for Petitioner Barclays, at pp. 10, 11. The only significant event preceding the enactment of Senate Bill No. 85 to which Barclays refers is the "retaliatory" legislation enacted in the United Kingdom in 1985. Barclays asserts that this legislation is the most obvious

foreign policy implication. Brief for Petitioner Barclays, at p. 27.

In response to petitioners' assertions regarding the risk of retaliation, amicus curiae submits that the fact that the United Kingdom negotiated and accepted the bilateral treaty which specifically excluded article 9(4), as originally negotiated, weighs strongly against the conclusion that the tax imposed by California might *justifiably* lead to significant foreign retaliation. See *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 194, 77 L. Ed. 2d 545, 572 (1983).

Barclays also relies on a number of events occurring subsequent to 1977, the latest tax year at issue, and purports to extrapolate therefrom a precise federal foreign policy that was in effect both prior to and during 1977: specifically, that the use of the arm's length method was required to be used by California. Brief for Petitioner Barclays, at pp. 5, 8, 23 to 25, incl. Pursuant to Barclays' reasoning, that policy is discerned through a dormant Commerce Clause analysis. Colgate makes a similar argument. Brief of Petitioner Colgate, at pp. 34, 35, 36, 40, 41, 42.

In this connection, petitioners assert both that the use of the arm's length standard was a critically important feature of foreign policy and that Congress took no action during the tax years at issue or in subsequent years, with respect to that precise and important foreign policy. Brief for Petitioner Barclays, at pp. 19 to 25, incl.; Brief of Petitioner Colgate, at pp. 6, 19 to 22, incl. If petitioners' claim of inaction by Congress is accepted, an interesting question is presented: If the specific foreign policy asserted by petitioners was so pressing and important,

why didn't Congress take any legislative action to ensure that the policy was implemented by the States?

The apparent contradiction raised by this question can be resolved rather simply. Congress *did* actually take action with respect to federal foreign commerce policy as it relates to worldwide combined reporting.

In this connection, amicus curiae submits that the fact that Congress has rejected various federal legislative proposals affecting the use of worldwide combined reporting by the states over a 20-year period commencing in 1965, see *Barclays Bank Internat., Ltd. v. Franchise Tax Bd.*, 2 Cal. 4th 708, 736, and the fact that a bilateral treaty was being negotiated at or about the time of the tax years in question, and that these negotiations were followed by the specific rejection of article 9(4), as originally negotiated, thereof by the United States Senate in 1978, see Remarks of Senators Cranston, Javits, and Pell, 124 Cong. Rec. 18400, 19076 (1978), make clear what federal foreign policy was for the tax years in question, irrespective of what that policy arguably may be currently. That policy was to not prohibit the continued use of worldwide combined reporting by the States.

For the foregoing reasons, amicus curiae submits that petitioners' assertion that worldwide combined reporting is prohibited by the inaction of Congress and dormant Commerce Clause analysis is incorrect.

E. The Application of Worldwide Combined Reporting to Petitioners Was Proper

The State of California, acting through the California Legislature, has exercised its sovereign power to tax

responsibly and with due deference to federal policy. The California Legislature recognizes that formulary apportionment has been approved for more than a century as a means of fairly dividing a single tax burden among several jurisdictions in which a taxpayer does business. The California Legislature recognizes that the Constitution grants to Congress, not the federal Executive, the power to regulate foreign and interstate commerce. The California Legislature is aware of the fact that Congress has specifically and continuously rejected any federal legislative ban on the use of worldwide combined reporting by the States.

The California Legislature is keenly aware of federal foreign commerce policy, and through California's large Congressional delegation, the State of California has contributed significantly to the formulation of that policy.

At the same time, the California Legislature is aware that federal policy can and does evolve over time. In this regard, the California Legislature has been closely attuned to the desires and concerns expressed by the federal Executive and the business community as exemplified by, among other things, the enactment in California of Senate Bill No. 85 and Senate Bill No. 671. However, the California Legislature believes that no foreign nation or corporation may dictate how the United States may conduct its foreign policy or how a State may conduct its sovereign power to tax.

Accordingly, amicus curiae submits that California's application of worldwide combined reporting to petitioners for the tax years at issue did not prevent the federal government from speaking with one voice when

regulating relations with foreign governments. Rather, the efforts of the California Legislature in enacting laws relating to worldwide combined reporting have been entirely consistent with the evolution of federal policy in this area, and have addressed specific concerns raised by the federal government and multinational corporations during that period of evolution.

CONCLUSION

For the foregoing reasons, amicus curiae urges this Court to affirm the decisions of the Court of Appeal of the State of California, Third Appellate District.

Respectfully Submitted,

BION M. GREGORY*
Legislative Counsel of California

JAMES A. MARSALA
Principal Deputy
Legislative Counsel

BALDEV S. HEIR
MICHAEL R. KELLY
Deputies Legislative Counsel

Attorneys for Amicus Curiae
*Counsel of Record

APPENDIX A

To President Clinton from Senate Democrats

We want to take this opportunity to thank you for your past support of California's position in the Barclays Bank PLC tax case, which is before the U.S. Supreme Court. Despite an amicus curiae brief from the Solicitor General urging the Court not to take the case, the Court has decided to hear Barclays, as well as the related Colgate-Palmolive case. California is again turning to you for support.

Should the Supreme Court decide in favor of both Barclays and Colgate-Palmolive, California stands to lose $4 billion in tax revenues. You repeatedly have stated your belief that as long as California's economy is stalled in recession, the United States cannot truly emerge into prosperity. While we believe the California economy is on the road to recovery, the loss of $4 billion in tax revenue would be devastating to the state's coffers and the state's economy.

In the closing month of this year's legislative session, California made major concessions to the multinationals and their respective governments by amending the tax code to address their concerns. These steps were undertaken in a spirit of cooperation with your Administration. These changes along with significant modifications in the workers' compensation and other business tax areas were all part of our concerted effort to assure that California's recovery can become a reality.

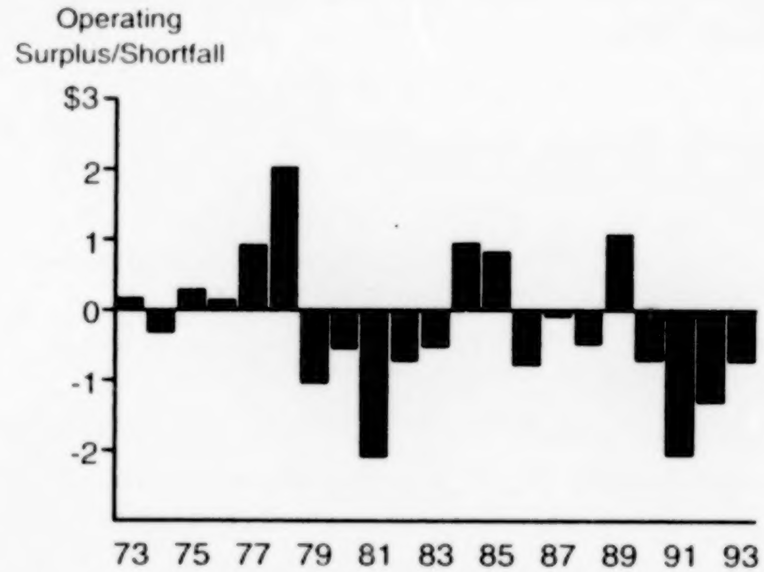
Your prior support of California on Barclays demonstrates your understanding of the need to protect the

taxing prerogatives of the states. It is vital that your Administration take an active role in supporting California before the Supreme Court. We urgently request that the Solicitor General be instructed to file an amicus brief in support of California in this matter. The deadline for filing briefs in support of California is January 14, 1994.

California's economy – and that of the nation – is in jeopardy. We need your help in order to prevail in this vital matter.

General Fund Operating Shortfalls Have Been Common In Recent Years[a]

(In Billions)



[a] Data are for fiscal years ending in year shown.

- Since Proposition 13 was approved in 1978, state General Fund spending has exceeded revenues in all but 3 years.
- 1992-93 will be the fourth consecutive year of operating shortfalls, resulting in an estimated 1992-93 ending budget deficit of $3.4 billion (absent corrective action).
- Operating shortfalls occurred even during the economic expansion of the mid-1980s.
- The relative size of the shortfalls has shrunk. The $2.1 billion 1980-81 shortfall was 9.9 percent of spending, but the $2.1 billion 1990-91 shortfall was only 5.1 percent of spending.

APPENDIX B

CALIFORNIA SCHOOL EMPLOYEES ASSOCIATION

Governmental Relations Office • 1127 11th St., Ste., 346 • Sacramento, CA 95814 • (916) 444-0598

March 17, 1986

TO: Assemblyman John Vasconcellos, Chairman and Members of the Assembly Ways and Means Committee

RE: SB 85 (Alquist) - OPPOSE

The California School Employees Association regretfully must oppose SB 85, to repeal the unitary method of taxiation [sic]. This measure is scheduled to be heard in your committee on Wednesday, March 19.

SB 85 will result in substantial tax breaks for multinational corporations, resulting in decreased revenues to the state. Combined with the impact of Gramm-Rudman the state will suffer from severe revenue losses and our experience leads us to the conclusion that our members will suffer. Not only will we suffer from reduced funding to schools which may cost us jobs, we could also be forced to pick up the slack by paying future tax increases.

All the data we have reviewed leads us to the conclusion that the repeal of the unitary tax will not substantially increase investment in California. California has led the nation in new investment despite the existence of the unitary taxation method.

We therefore urge your "NO" vote on SB 85.

Sincerely,

CALIFORNIA SCHOOL EMPLOYEES ASSOCIATION

/s/ Dave Low SR
Dave Low
Governmental Relations Representative

DL/sb
cc: Samuel Yockey
Legislative Analyst

THE NATION'S LARGEST CLASSIFIED SCHOOL EMPLOYEE ASSOCIATION

CALIFORNIA FIRST BANK

[Logo]

OFFICE OF THE PRESIDENT, LOS ANGELES
616 WEST 6TH STREET, LOS ANGELES, CALIFORNIA 90017
(213) 972-5260

YOSHIAKI SHIBUSAWA
EXECUTIVE VICE PRESIDENT

March 22, 1985

The Honorable William P. Baker
3013 State Capitol
Sacramento, CA 95814

Dear Mr. Baker:

I wish to thank you once more for taking time from your busy schedule to discuss the unitary tax reform bills. As you know, California First Bank is most concerned about the provision in the bills which deal with

the inclusion or exclusion of foreign banks from the "water's edge" group. I very much appreciated your willingness to listen to our point of view on this issue and, if I may, I would like to take this opportunity to reiterate it in writing.

The provision in the August 28, 1984 draft of Senator Alquist's SB 1437 concerning this issue is:

> "[A taxpayer shall include the following entities in the water's edge group] . . . (7) Any affiliated bank or corporation, regardless of the place where it is incorporated, if more than 20% of its payroll, property or sales is assignable to a location within the United States."

If a foreign bank exceeds this 20% threshold, then its U.S. subsidiary would be required to include the foreign bank in a unitary tax return for the water's edge group and thus the U.S. subsidiary would *not* benefit under the proposal. The Bank of Tokyo, Ltd., the parent corporation of California First Bank will fail to be excluded from the unitary tax return of California First Bank under this threshold provision, and we request that certain technical changes be made to change this result.

For most foreign corporations, the threshold issue is not significant, because foreign corporations generally operate in the U.S. through subsidiaries and therefore have *no* direct presence in the United States. It is also relatively easy for a foreign corporation to convert a branch into a subsidiary.

The banking industry, however, is subject to unique regulatory constraints which are not imposed on corporations in general. In particular, existing bank regulatory

and licensing procedures have caused foreign banks to establish agency and branch offices in the United States. Also, it is generally not feasible to convert an agency or branch into a subsidiary. Because these agencies and branches are not separate subsidiaries, the factors of such agencies and branches in the Unites [sic] States are taken into account when applying the threshold test.

Our particular problem with the proposed threshold test is that the Bank of Tokyo, Ltd. would be included in California First Bank's unitary tax return, because currently its "sales" (gross revenues) assignable to locations within the United States may be as high as 28%. Yet the average of its payroll and property factors is only about 10%. One reason the sales factor is much higher than the other two factors is that the sales factor is inflated by the substantially higher interest rates in the United States as compared with Japan. The sales factor is also volatile, because it is impacted by currency fluctuations and changing market conditions. The technical change California First Bank requests is to change the threshold test for foreign banks. Instead of a 20% property, payroll or sales test, the test for foreign banks could be a 20% property or payroll test. This would eliminate the unpredicability [sic] of the sales factor. Alternatively, a three factor average of 20% could be used. This would at least lessen the significance of the sales factor. We also note that averaging the three factors is similar to the general formula apportionment method. The adverse effect on state revenue by making this type of technical change for the foreign banking industry should not be substantial.

Of all the Japanese-owned companies in California, California First Bank is the largest contributor to the state's employment. California First Bank employs over 4,000 California residents statewide. It would be ironic if the U.S. subsidiary with one of the largest California payrolls would be the one subsidiary which is not protected by unitary tax reform. It is also significant that 98% of all of the shareholders of California First Bank are U.S. residents (although 76.6% of the total shares are held by The Bank of Tokyo, Ltd.). It would also be ironic if the U.S. subsidiary with one of the largest groups of U.S. shareholders were not protected by unitary tax reform, since under the circumstances about 23% of the unitary tax is actually borne by those U.S. shareholders.

In summary, California First Bank requests that you support the water's edge approach developed by Senator Alquist last year (and reintroduced this year as AB No. 157 by Assemblyman Dennis Brown) with one technical modification. California First Bank requests that the threshold test be modified so that foreign banks are included within the water's edge group *only if* the property or payroll factors of the foreign bank is greater than 20% (or alternatively, only if the average of the property, payroll and sales factors is greater than 20%). California First Bank would be most appreciative of your kind and thoughtful attention to this matter.

Sincerely yours,

/s/ Yoshiaki Shibusawa
Yoshiaki Shibusawa
Executive Vice President

CASTLE & COOKE, INC. FIFTY CALIFORNIA STREET SAN FRANCISCO, CA 94111
TELEPHONE (415) 986-3000
TELEX 340295

R. D. COOK
PRESIDENT

August 21, 1985

The Honorable William Baker
Vice Chairman, Ways and Means Committee
State Capitol
Sacramento, California 95814

Dear Mr. Baker:

On behalf of Castle & Cooke, Inc., an agricultural company employing over 10,000 Californians, we assure you Unitary Tax Reform is a major concern to our company and our employees.

On August 28, 1985, as Vice Chairman of the Ways and Means Committee, you will review Unitary Tax Reform for California. All that our company and its employees request is equity.

The management of Castle & Cooke, Inc. was very concerned about what was going to happen to our 10,000 California employees while we were on the brink of bankruptcy in the spring of this year. Passage of a Unitary Tax Reform Bill which favors foreign-based companies will reverberate as a message that California legislators are not concerned about employment for these 10,000 Californians.

Senate Bill 85 will reduce the California tax expense for our foreign competitors while keeping ours at its current level. No tax benefit flows to Castle & Cooke, Inc. in SB 85 while a sizeable benefit flows to our foreign competitors.

Why would you want to provide a tax incentive to foreign-based multinationals which tips the scales of cost competitiveness even further? The huge trade imbalance with our foreign trading partners indicates no such incentive is required.

Castle & Cooke, Inc. respectfully requests that you express support for American business and vote NO on SB 85.

We would greatly appreciate hearing your thoughts on Unitary Tax Reform and if you have any questions, please let us know.

Sincerely,

/s/ R. D. Cook
R. D. Cook, President
CASTLE & COOKE, INC.

Western
Union
Mailgram [Logo]

WUTELCO
1116 12TH STREET
SACRAMENTO CA 95814 23AM

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06 SACRAMENTO CA 23-AUG-85

ASSEMBLYMAN WILLIAM BAKER
ROOM 3013
STATE CAPITOL
SACRAMENTO, CA 95814

DEAR

IT SEEMS THE COMPLICATIONS SURROUNDING UNITARY TAX REFORM ARE NEVER ENDING. NOW, A NEW AND UNFORSEEN [sic], BUT MOST SIGNIFICANT PROBLEM HAS ARISEN WHICH COULD ENCOURAGE FOREIGN-OWNED CALIFORNIA BANKS TO LIMIT EXPANSION IN CALIFORNIA, REDUCE THEIR PAYROLLS AND THE NUMBER OF PEOPLE EMPLOYED. THIS WOULD, OF COURSE, BE CONTRARY TO THE INTENT OF SENATE BILL 85.

AS YOU KNOW, ON JULY 18, SB 85 WAS AMENDED TO HELP REDUCE THE TAX COMPLIANCE BURDENS OF FOREIGN BANKS WITH U.S. BRANCHES. THESE AMENDMENTS, WHILE TAKING CARE OF ONE PROBLEM, INADVERTANTLY AND IRONICALLY, CREATED ANOTHER.

VERY SIMPLY, FOREIGN-OWNED CALIFORNIA BANKS WHICH EMPLOY LARGE NUMBERS OF CALIFORNIANS, 28)) 0-6 #8&#34 '5-53 8,:9.3 5-/3' 7,ER SB IT [missing text in original] AS AMENDED, SOLELY

BECAUSE THEY EMPLOY LITERALLY THOUSANDS OF CALIFORNIANS AND HAVE, THEREFORE, SUBSTANTIAL CALIFORNIA PAYROLLS.

THIS ADDITIONAL BURDEN OCCURS BECAUSE OF STRUCTURAL FEATURES IN THE BANKING SYSTEM WHICH CANNOT BE EASILY CHANGED; PRIMARILY HIGH EMPLOYMENT FIGURES BY LARGE CALIFORNIA RETAIL BANKS AND LOW EMPLOYMENT FIGURES IN U.S. BRANCHES OF FOREIGN BANKS (PRINCIPALLY NEW YORK) WHICH DO NOT CONDUCT RETAIL BANKING. UNDER SB 85, AS AMENDED ON JULY 18, THESE U.S. BRANCHES OF FOREIGN BANKS ("DEEMED SUBSIDIARIES") WILL BE COMBINED WITH CALIFORNIA RETAIL BANKS FOR TAX PURPOSES.

JAPANESE-OWNED CALIFORNIA BANKS EMPLOY MORE THAN 100,000 CALIFORNIA RESIDENTS. AS A RESULT, THEIR CALIFORNIA PAYROLL FACTORS RANGE FROM 70-80 PERCENT WHEN CALCULATED FOR A WATER'S EDGE GROUP WHICH INCLUDES A "DEEMED SUBSIDIARY" OF A FOREIGN PARENT BANK. BUT, THE CALIFORNIA SALES AND PROPERTY FACTORS OF SUCH A GROUP WOULD BE MUCH LESS, OFTEN 20-40 PERCENT. THIS IMBALANCE WILL RESULT IN AN INCREASE IN THE CALIFORNIA TAXES OF A CALIFORNIA BANK SIMPLY BECAUSE IT EMPLOYEES [sic] A LOT OF PEOPLE AND HAS A HIGH PAYROLL FACTOR.

THIS NEW PROBLEM CAN BE SOLVED EITHER (I) BY EXTENDING THE APPLICATION OF THE 20 PERCENT AVERAGE THRESHOLD TEST CURRENTLY IN THE BILL (AND WHICH IS APPLICABLE TO FOREIGN CORPORATIONS) TO FOREIGN BANKS OR (II) BY PERMITTIG [sic] FOREIGN BANKS TO ELECT TO BE TAXED LIKE FOREIGN CORPORATIONS FOR PURPOSES OF APPLYING THE WATERD'S [sic] EDGE PROVISIONS. WE REQUEST THAT YOU CONSIDER THESE ALTERNATIVES.

1. CALIFORNIA FIRST BANK (PHONE 213-972-5260 C/O MR. SHI BUSAWA) SISHICHI ITOH, PRESIDENT.

2. GOLDEN STATE SANWA BANK (PHONE 213-614-0400) TERUYOSHI YASUFUKU, CHAIRMAN AND PRESIDENT.

3. THE MITSUBISHI BANK OF CALIFORNIA (PHONE 213-621-1200). TSUNEYOSHI KAJIWARA, PRESIDENT.

4. THE SUMITOMO BANK OF CALIFORNIA (PHONE 415-445-8151). TERUHISA SHIMIZU, PRESIDENT.

WU TELTEX SAC

15:47 EST

MGMCOMP

[Logo] California Teachers Association

GOVERNMENTAL RELATIONS DEPARTMENT

1127 Eleventh Street, Suite 450,
Sacramento, California 95814
(916) 442-5895

August 23, 1985

The Honorable William Baker
Member, Assembly Ways & Means Committee
State Capitol, Room 3013
Sacramento, CA 95814

Dear Assemblymember Baker:

The California Teachers Association is ***opposed*** to SB 85 (Alquist). The repeal or limitation of the unitary method will cause a substantial and continuing loss of state revenues. And, we believe any significant reduction in state revenues will reduce funding available for the public school system of this state.

We respectfully urge your "*NO*" vote when SB 85 is heard by the Ways and Means Committee.

If you have any questions or concerns regarding our position on this measure, please contact CTA Legislative Advocate Rachel A. Joseph at (916) 442-5895.

Sincerely,

/s/ Alice A. Huffman
Alice A. Huffman
Director of Political Affairs

AAH/RAJ/dh

[Logo]
California Chamber of Commerce

1027 10th Street, 4th Floor
• P.O. Box 1736 • Sacramento, CA 95808 •
(916) 444-6670

August 23, 1985

The Honorable William Baker
California State Assembly
State Capitol
Sacramento, CA 95814

Dear Mr. Baker:

Subject: ***SB 85 (Alquist) Unitary Tax Reform***

The California Chamber of Commerce has reviewed ***SB 85 (Alquist)*** *and* ***opposes*** *the bill in its current form. The Chamber believes reform of the unitary tax is essential to continued job growth and economic development in California. SB 85 shows a recognition of the need for change by allowing companies the ability to file tax returns under a water's-edge combination rather than the worldwide method of combination. However, the California Chamber does not feel SB 85 achieves sufficient reform. The Chamber's position is based on the following reasons:*

1. Foreign source income of American companies is still subject to tax. *Worldwide unitary combination is inappropriate tax policy because it taxes foreign income. SB 85 allows companies to elect water's-edge combination, but taxes foreign dividends which are returned to the United States. For American companies, this means they are still subject to tax on that foreign income. The American companies must not only pay tax on the foreign source income, but by electing water's-edge*

treatment they do not have the benefit of the factor relief that the foreign operations provide.

*2. **SB 85 puts American business at a competitive disadvantage.** Because SB 85 taxes the foreign source income of American multinationals, but not foreign multinationals, American companies [are] at a competitive disadvantage. California's business community operates on a worldwide scale. They are able to compete with anyone in manufacturing and sales if they are given an equal playing field. But, American business cannot compete with a tax policy that gives their foreign competition a built-in advantage.*

*3. **Unitary reform should not increase other taxes or fees.** SB 85 requires companies electing a water's-edge combination to pay an offsetting tax. The "levy" is clearly a tax because it goes to fund general governmental services, there is no relationship between the amount of the levy and the benefit received by the payor, it is levied on the same basis as the current unitary tax, and it goes on indefinitely.*

The economic growth resulting from unitary reform will mean more property and sales tax revenue to local governments, and income taxes to the state from new employees.

The California Chamber of Commerce has a broad policy on the reform of the unitary tax, which I have enclosed. The Chamber is open to discussion of that policy and any possible agreement. We have indicated this position to Senator Alquist. We hope that he would amend his bill in line with that policy, or in the alternative back to the version of the bill as amended January 24.

In its current form, the California Chamber of Commerce urges a NO vote on SB 85.

Sincerely,

/s/ Fred L. Main
Fred L. Main
Manager/Tax Counsel
Taxation Group

FLM:jrr
Enclosure

Organization for Fair Taxation
of International Investments
100 Manhattanville Road
Purchase, New York 10577

NEIL H. GREEN
CHAIRMAN
(914) 251-3961

January 15, 1988

California Franchise Tax Board
Legal Department
Attention: Ms. Susan Borgman
P.O. Box 1468
Sacramento, California 95807-1468

Comments on Proposed Reglations [sic] *25110, 25111, 25112, 25114, and 25120*

Dear Ms. Borgman:

The attached comments are made pursuant to the published invitation of the Franchise Tax Board.

OFTII is a Delaware non-profit corporation, whose members are U.S. subsidiaries of foreign corporations. OFTII

was organized to represent its members' interests in matters relating to Federal and State taxation. OFTII members have very substantial investments in the United States, including significant investments in the State of California. A list of OFTII members showing the nationality of each member's foreign parent is attached.

I trust that our comments will be useful to you. Should you have any questions, please call me at the number above. If you would like to have a detailed discussion of these comments, we would be pleased to organize a visit to Sacramento by one or more of our members.

Yours sincerely,

/s/ N. H. Green
N. H. Green

NHG/ys
Attachments

OFTII MEMBERS

AKZO America, Inc.	Holland
Alcan Aluminum Corporation	Canada
Allied Lyons North Anmerica [sic]	United Kingdom
Barclays Bank	United Kingdom
Batus, Inc.	United Kingdom
British Petroleum of North America	United Kingdom

BASF American Corporation	Germany
Beecham, Inc.	United Kingdom
Elf Aquitaine, Inc.	France
Foseco Minsep	United Kingdom
Gold Fields American Corp.	United Kingdom
GKN North America, Inc.	United Kingdom
American Hoechst Corporation	Germany
ICI Americas, Inc.	United Kingdom
Moet et Chandon	France
Nestle Holdings, Inc.	Switzerland
Shell Oil Company	UK/Holland
Siemens Capital Corporation	Germany
Sony Corporation of America	Japan
Volkswagen of America	Germany
Volvo of America	Sweden
Unilever United States	UK/Holland
Thorn EMI (USA), Inc.	United Kingdom

31 October 1988 [Logo]

ORGANIZATION FOR
FAIR TREATMENT OF
INTERNATIONAL
INVESTMENT INC.

Wilmington, DE 19897
Tel. (302) 575-3738
Fax. (302) 575-2952

California Franchise Tax Board
P.O. Box 1468
Sacramento, CA 95807-1468

Comments on proposed Regulations 24344(c), 24411, 25110, 25111, 25112, 25114, 25115, and 25401d.

These comments are offered pursuant to the published invitation of the Board.

OFTII is a nonprofit corporation all of the members of which are domestic taxpayer corporations owned or controlled, directly or indirectly, by nondomestic shareholders or corporations. OFTII members have very substantial investments in the United States, including the State of California. There is annexed a list of OFTII members on whose behalf these comments are submitted.

The Board are to be commended for proposing revised regulations that consist with the amended version of SB 85 so soon after that Act's adoption. The second annexure contains some observations of technical problems in a few paragraphs of the revised proposals. These observations do not denigrate the fact that, on the whole, the Board have done a very good job of interpreting SB 85 in a reasonable manner. The principal difficulty noted by OFTII is not the text the regulations proposed, but the

subjects that they *do not cover*: namely, the fundamental problems of who is subject to worldwide combined income reporting and apportionment and, hence, who is properly constrained to make the water's edge election provided in Reg. 25110. This issue is much broader than Reg. 25110, itself. The attempt to resolve these issues by simply referring to cases decided by the United States Supreme Court, the California courts, and the State Board of Equalization (see Reg. 25110, subdivision (d)) provides no real guidance for taxpayers or Board auditors and will simply produce more litigation as these issues are contested on a case by case basis.

The attempt to define a "unitary business" in eleven lines in Reg. 25110(b)(4) does nothing to clear up the enormous confusion that has been the source of years of litigation concerning who is and who is not subject to UDITPA apportionment. In July 1987, the Franchise Tax Board circulated a discussion draft of proposed regulations entitled "Determination of Separate or Unitary Business," numbered 25120(b). These regulations were never listed for hearing and, so far as taxpayers are aware, never progressed past the discussion stage. While there were a number of specific problems with those proposed regulations, they endeavored to fill a pressing need: The establishment of guidelines for the determination of such important basics as who is a "taxpayer" and what is a "unitary group." The State Board of Equalization recently noted the ambiguity that exists in existing regulations concerning the meaning of "taxpayer." In *Appeal of Finnigan Corp.* 88-SBE-022, pp. 161-162 (1988) the Board stated with reference to Reg. 25121(d), that "the word 'taxpayer' is used in, at least, two senses; one in which

the taxpayer is taxable in California, and another in which the 'taxpayer' is not taxable in the state." The United States Court of Appeals for the Seventh Circuit has recently upheld the right of foreign companies whose income was apportioned to California to maintain actions *in federal court* to challenge that apportionment because California refused to grant these foreign companies access to California Courts. *Alcan Alum. v. Franchise Tax Bd.* No. 87-2239, 19 October 1988. The need for clear and workable definitions must be met to avoid even greater confusion and more litigation in the future.

There is a particular need for definitions of "centralized management," "functional integration," "taxpayer," "taxpayer group," and "trade or business," just to name some of the more obvious. Most of the taxpayer disputes with the FTB that have arisen over the last few years have grown out of claims of arbitrary determinations of FTB auditors in deciding who is subject to apportionment, and what types of income are to be included. E.g., Alcan Aluminium Ltd., Shell Oil Corp., EMI Ltd., Imperial Chemical Industries, Barclay's Bank, and Container Corp., just to name some taxpayers who have gone to court or are still in court to press their claims that income was unfairly or improperly apportioned. These issues will not go away until some clear guidelines are established for the benefit of taxpayers and FTB auditors alike. The place to start is with the definitional regulations.

OFTII will be pleased to discuss in detail any matters relating to regulations with Board members or with staff, if such discussion would prove helpful. Please call the

undersigned if it is believed that OFTII can be of assistance.

/s/ Illegible Signature
J.M. Carter
Secretary

Annexures (2)

Directors: Harry Corless, Chairman • Ned W. Bandler • Robert E. Dillon • Donald J. Kapraly • Leonard D. Levin • Alex Spitzer

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UNITARY TAX CAMPAIGN

Unitary Tax Campaign Limited
19 Catherine Place, London SW1E 6DX
Tel: 01-630 5651
Facsimile: 01-821 1490 Telex: 296438 IGAUK G

CAMPAIGN CO-ORDINATING COMMITTEE:
BAT Industries plc., Barclays Bank plc.,
Foseco Minsep plc., Glaxo Holdings plc.,
Hawley Group plc., Imperial Chemical Industries plc.,
National Westminster Bank plc.,
CAMPAIGN ADVISERS:
Ian Greer Associates Limited

January 26, 1988

BY FEDERAL EXPRESS

California Franchise Tax Board
Legal Division
Post Office Box 1468
Sacramento, California 95807-1468
U.S.A.

Attn: Susan Borgman

RE: Unitary Tax Administrative Regulations

Dear Ms. Borgman:

The Unitary Tax Campaign (UTC) and the Confederation of British Industry (CBI) which represent British international companies that have investments in the United States, are pleased to have the opportunity to comment on the proposed administrative regulations.

We have, as you are well aware, consistently opposed the use of worldwide unitary taxation and continue to do so. We welcome in the legislation recognition of the problems created for British business by the use of worldwide unitary tax, but have a number of very serious reservations about it which we have set forth over the years in various communications to interested parties, including the Franchise Tax Board. These include the election fee, the lengthy election period, the continued ability of the Franchise Tax Board to throw taxpayers back onto worldwide combined reporting and the continued compliance burdens. We believe that the combination of these measures will lead to almost all companies not electing. Unfortunately, the legislation and now the regulations, create more uncertainty than ever before. Seeing the two in combination makes us realize that we have a substantial way to go in resolving the difficulties of the unitary problem.

Nevertheless, we are enclosing detailed comments on the draft regulations. We have substantial difficulties with segments of the legislation itself, but we have for the most part confined our comments to the regulations. We strongly believe that the regulations go far beyond the letter and spirit of the legislation passed in September, 1986.

We would be very happy to discuss with you any of the points we have made if you feel that such a meeting would be beneficial. Finally, we hope that the commitment to limiting the use of worldwide unitary tax can be translated into satisfactory and effective legislation and regulations.

Yours sincerely,

/s/ Peter J. Welch/j
Peter J. Welch,
Chairman,
Unitary Tax Campaign

/s/ Keith McDowall/j
Keith McDowall
Deputy Director-General
Confederation of British Industry

UNITARY TAX CAMPAIGN

Unitary Tax Campaign Limited
19 Catherine Place, London SW1E 6DX Tel: 01-630 5651
Facsimile: 01-821 1490 Telex: 296438 IGAUK G

CAMPAIGN CO-ORDINATING COMMITTEE:
BAT Industries plc., Barclays Bank plc.,
Foseco Minsep plc., Glaxo Holdings plc.,
Hawley Group plc., Imperial Chemical Industries plc.,
National Westminster Bank plc.,
CAMPAIGN ADVISERS:
Ian Greer Associates Limited

28th June, 1988.

Ms. Susan Borgman,
California Franchise Tax Board,
Legal Division,
Post Office Box 1468,
Sacramento,
California 95807-1468
United States of America.

Dear Ms. Borgman,

UNITARY TAX ADMINISTRATIVE REGULATIONS

We are enclosing detailed comments on the second draft of the regulations.

We are very concerned that only one of our substantive comments, on the earlier draft, has been accepted by the FTB. It is fair to say that it is not one of our major points of principle. The UTC and CBI continue to see the regulations as going beyond the spirit and letter of the original legislation, which both the UTC and CBI did not feel able to support.

British business does not think that where we are will solve the problem. A combination of the election fee, the election period, the absence of refund provisions, the 'throw back' provisions and the tone of the second draft of the regulations (and the implications for compliance) are seen by British business as reason for not electing for 'water's edge'. In fact, no member of the UTC currently expects to elect and we understand that, at a meeting earlier this year in the US, only three companies out of about two hundred indicated an expectation of electing. It was interesting that the US Treasury and representatives of the Governor's office in Washington and London, confirmed our analysis that the problem has not been solved.

We would be happy to discuss with you any of the points we have made.

Yours sincerely,

/s/ Andrew Smith pp PETER J. WELCH Chairman Unitary Tax Campaign	/s/ Andrew Smith pp KEN EDWARDS Deputy Director-General Confederation of British Industry

UNITARY TAX CAMPAIGN

Unitary Tax Campaign Limited
19 Catherine Place, London SW1E 6DX Tel: 01-630 5651
Facsimile: 01-821 1490 Telex: 296438 IGAUK G

CAMPAIGN CO-ORDINATING COMMITTEE:
BAT Industries plc., Barclays Bank plc.,
Foseco Minsep plc., Glaxo Holdings plc.,
Hawley Group plc., Imperial Chemical Industries plc.,
National Westminster Bank plc.,
CAMPAIGN ADVISERS:
Ian Greer Associates Limited

1st November, 1988.

Ms. Susan Borgman,
Legal Division,
California Franchise Tax Board,
PO Box 1468,
Sacramento,
California 95807-1468
United States of America.

Dear Ms. Borgman,

UNITARY TAX ADMINISTRATIVE REGULATIONS

We are enclosing detailed comments on the amended version of the second draft of the regulations.

We would be happy to discuss with you any of the points we have made.

Yours sincerely,

/s/ Andrew Smith pp PETER J. WELCH Chairman Unitary Tax Campaign	/s/ Andrew Smith pp KEN EDWARDS Deputy Director-General Confederation of British Industry

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TIM LESLIE VICE CHAIRMAN	STAFF DIRECTOR STEVE LARSON
DAN BOATWRIGHT CHARLES CALDERON GARY HART FRANK HILL QUENTIN KOPP DAN McCORQUODALE REBECCA MORGAN NICHOLAS PETRIS MIKE THOMPSON DIANE WATSON CATHIE WRIGHT	DEPUTY DIRECTOR PATRICK LENZ CONSULTANTS TIM DAVIS JOHN GRIFFING FREDERICK HARRIS SAM OBREGON ANDREW SCHAEFER KEITH UMEMOTO COMMITTEE SECRETARY BARBARA BESSON

California State Senate

COMMITTEE
ON
BUDGET AND FISCAL REVIEW

ROOM 5013, STATE CAPITOL
SACRAMENTO, CALIFORNIA 95814
(916) 445-5202

ALFRED E. ALQUIST
CHAIRMAN

July 14, 1993

Kirk West, President
California Chamber of Commerce
12th Floor, 1201 K St.
Sacramento, CA 95812-1736

Dear Kirk:

In 1986, after several years of intense discussion and negotiation, the California Legislature passed and the Governor approved my SB 85, which provided for a water's edge election. Under this legislation it is now

possible for a multinational group of corporations operating a unitary business to elect to have their California income share determined on a "water's edge" basis rather than under the traditional "worldwide combination" method. The election is accomplished by entering into a contract with the State for a minimum term of five years. The contract requires the taxpayer to comply with certain documentation requirements, to include certain income within the water's edge base, and to pay a relatively modest "election fee" (equal to 0.03% of the sum of it's [sic] California payroll, property and sales factors).

Although there has been scattered grumbling about some of the terms of the water's edge election, generally the business community has been pleased with the results of the SB 85 compromise. However, persistent complaints from some foreign-owned companies and their governments have prompted me to consider a serious review of California's treatment of multinational businesses.

As a beginning step toward that end, Senators Roberti and Maddy have joined me in amending SB 671 to require that our current water's edge method no longer be elective, but be mandatory on all worldwide groups of corporations doing business in California. This approach has not been greeted warmly by the domestic multinationals and it does not necessarily conform with what my colleagues in the Senate and I believe to be the appropriate reform. Therefore, SB 671 was amended in the interest of discussing the issues surrounding unitary taxation in the mid-1990's, and to serve as the vehicle for potential modifications should these prove necessary.

I have attached a chart outlining a range of alternatives to the current water's edge approach, which may serve to frame the broader aspects of the issue for our hearing in the Senate Revenue and Taxation Committee on August 18.

One factor which I should emphasize above all else is that any reform to our present unitary method must not serve as an opportunity to derive additional tax concessions from the State of California which would further erode the state's precarious fiscal position.

Please let me know your views on potential reforms to the water's edge method, so that we may all understand where everyone stands on the issue.

Sincerely,

/s/ Alfred E. Alquist
ALFRED E. ALQUIST

cc: Other Interested Parties

Unitary Options

1. Do nothing (leave SB 85 water's edge approach in place)	This "null" approach would be unlikely to placate the British and it would not lend support to a U.S. administration position that "California is doing it's part to resolve this difficulty." However, in face of some alternatives, a large number of domestic-based corporations would prefer this option.	Revenue neutral
2. Adopt "mandatory water's edge" approach (SB671 – Alquist)	Apparently requested by both U.S. Treasury AND British representatives, this approach would disadvantage a large number of mainly domestic-based corporations who prefer (for reasons of tax minimization) to remain under world-wide combination.	Revenue gain of $100 plus million, which could be balanced by a reduction in the franchise tax rate from 9.3% to 9.1%
3. Revert to pre-SB 85 system (mandatory worldwide combination)	SB 85 (Alquist – 1986) was a heroic attempt to resolve domestic and international concerns over our worldwide method. If British retaliation is a sign that the attempt was an utter failure, then perhaps it should be abandoned.	Revenue gain of $300 plus million (which could be balanced by a rate reduction do 8.7%)
4. Take a step beyond SB 85 by providing a permanent election to use water's edge OR worldwide combination, with no election fee.	If the SB 85 election-with-fee structure was considered a temporary stopgap and an attempt to extract a *quid pro quo* from those electing water's edge, then perhaps the time has come to consider "normalizing" the system by treating water's edge on a par with worldwide combination. (This option would also involve removing FTB's ability to disregard the election, and perhaps the domestic disclosure spreadsheet (DDS).)	Revenue loss of $100 million (about half of which would be loss of the election fee). Could be balanced by an increase in tax rate to 9.5%.
5. Adopt AB 2084 (Takasugi), which repeals the DDS and the FTB disregard power.	A minimalist response, which could serve to test the proposition that the point which angers the British the most is FTB's power to unilaterally disregard the election.	Relatively minor and speculative revenue loss if a monetary penalty is substituted for FTB's disregard power.
6. Adopt a hybrid system, which would (1) continue the election fee for those who wish the option of reverting to worldwide at some time, and (2) provide a permanent election (as in 4. above) for those who wish to avoid the election fee.	This option would contain the features of 4., above, and would test the notion that unitary corporate groups would desire the option of electing OUT of water's edge should events turn out differently than planned.	Revenue loss of less than $100 million, to the extent that some groups would continue to use the temporary election, and pay the fee. A tax rate of between 9.3% and 9.5% might balance the package.

Note that all revenue estimates mentioned above are speculative, and would need to be confirmed by FTB and Finance.

Senate Rev & Tax mh July 13, 1993

APPENDIX C

CBI

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Facsimile 01-240 1578

From
Maurice Hunt
Deputy Director-General

17 August 1993

The Hon David A Roberti
President pro Tempore
California State Senate
State Capitol
Room 205
Sacramento
California
95814
USA

Our ref 08/07

Dear Senator Roberti,

Unitary Taxation

I am writing to you in connection with the discussions on unitary taxation about to take place in the Californian [sic] Legislature.

Unitary taxation on a worldwide combined reporting basis is a matter which is of vital importance and increasing concern to British business. Our concern has been reflected in the action we have taken over the years both in California and elsewhere in the United States by way of submission of written and oral evidence in relevant legislative and judicial proceedings with a view to securing its curtailment.

To assist in the current deliberations I am enclosing some material which explains more fully the problems which California's unitary tax system creates for British companies wishing to establish themselves in or do business with California.

If you would like further copies we shall be pleased to provide them. I hope that you will find this material helpful as a guide to how we in British business see the situation overall.

If there is any further assistance we can provide please do not hesitate to let me know.

Yours sincerely,

/s/ Maurice Hunt
Maurice Hunt

Enc.

CBI

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 071-379 7400
Facsimile 071-240 1578
Telex 21332

From
Maurice Hunt
Deputy Director-General

27 August 1993

Mr Fred Silva
Chief Consultant
Fiscal Unit
State Capitol, Room 400
Sacramento
California 95814
USA

Our Ref. 08/07

Dear Mr. Silva,

Californian Unitary Tax: SB671 (amended 23/8/93)

In our position paper on Californian unitary tax which we sent you earlier this month we explained a number of difficulties which British business had identified with the existing Californian unitary tax legislation in the hope that our explanation would be of assistance to you in the current review of this tax, in particular the debates on SB671.

Following the amendments made to SB671 up to 23 August 1993 we are pleased to note that a number of our concerns have been acknowledged by the Californian

authorities as warranting changes to the unitary tax regime.

At the same time however there remain a number of serious concerns which still need to be addressed. We offer some further thoughts on these based on the amended text of SB671.

Again we put these forward in a constructive spirit with a view to assisting in the crafting of legislation to meet the fundamental difficulties which we identified in our previous paper. Our central objective in this is to ensure that taxpayers have an unconditional entitlement to water's edge treatment.

Yours sincerely,

/s/ Illegible Signature
pp
Maurice Hunt

Enc.

NATIONAL FOREIGN TRADE COUNCIL, INC.

1625 K STREET, N.W., WASHINGTON, DC 20006

Tel: (202) 887-0278 [LOGO] FAX: (202) 452-8160

NEW YORK OFFICE:
1270 AVENUE OF THE AMERICAS,
NEW YORK, NY 10020-1700
• TEL: (212) 399-7128 • FAX: (212) 399-7144

August 12, 1993

The Honorable David Roberti
California State Senate
Capitol Building
Room 205
Sacramento, CA 95814

Dear Senator Roberti:

The National Foreign Trade Council, Inc. (NFTC) appreciates the opportunity to comment on prospective legislation (S.B. 671) being considered by the California legislature to revise the method by which foreign and domestic multinational companies are taxed on their business operations in California.

The NFTC is a trade association with some 500 members, founded in 1914. Its membership consists primarily of U.S. corporations engaged in all aspects of international business, trade, and investment. The NFTC's objective is to encourage policies that will expand U.S. exports and enhance the competitiveness of U.S. companies by eliminating major tax and trade inequities in the treatment of U.S. companies conducting business abroad.

On behalf of its member companies, the NFTC has been quite active in efforts to pursue a legislative solution in California that satisfies both the revenue concerns of

the State of California and avoids retaliation by the UK and other foreign governments against U.S. business interests operating in their countries. Many member companies of the NFTC have a substantial presence in California and also in the UK and in other foreign countries.

As you are aware, the UK has threatened to retaliate by denying the refund (ACT) available to U.S. companies under the existing UK-U.S. Income Tax Treaty unless California adopts legislation by the end of this year to repeal the mandated use of the worldwide unitary Method for UK companies conducting business in California. Similar complaints have been lodged against the unitary method by other EC countries, including Germany and the Netherlands.

The overriding objective of the NFTC is to press for enactment of legislation in California prior to the date of adjournment this year which meets California's revenue requirements and satisfies the concerns of the UK to avoid retaliation against U.S. business interests. (Emphasis supplied)

The NFTC offers the following comments and suggests modifications to S.B. 671 in order to satisfy the concerns of the UK and other foreign governments and also to provide a fair taxing regime in California for both U.S. and foreign multinational companies.

1. *Waiver of election Fee.* The fee imposed under present law to elect the water's edge method for filing should be repealed. We believe that inclusion of this recommendation in legislation is essential to avoid UK retaliation.

2. *The election of a water's edge method should be irrevocable.* The ability of multinational companies, both foreign and domestic, to elect use of the water's edge method for filing must be irrevocable. If the authority of the Franchise Tax Board officials to revoke the water's edge election under present law is retained, it is quite certain that the UK will retaliate against U.S. interests.

3. *The domestic spreadsheet should not be required.* The domestic spreadsheet requirement should be deleted. The compliance costs to companies of providing this information vastly exceeds any audit advantage to California taxing authorities. The NFTC and its membership can support the alternative suggestion of the Franchise Tax Board that a list of 20 percent or more owned affiliated corporations could be provided by companies with a minimum of one billion dollars in assets.

While the NFTC has other modifications that it could suggest to improve the tax system for multinational companies, both foreign and domestic, in California, the compelling need for enactment of legislation by the date of adjournment to avoid UK retaliation dictates that other recommended changes must be deferred for consideration until a later date. Adoption of legislation by California that includes the items recommended above should satisfy UK concerns and avoid a destructive tax war between the U.S. and its major trading partners that would undermine the investment climate in both countries.

The NFTC commends you and your colleagues in the California legislature for your efforts to seek a solution to this troublesome problem. The NFTC recognizes that any

solution must carefully balance the interests of the State of California and its need for revenue neutrality against the potential losses to be suffered by U.S. businesses operating abroad if countries, such as the UK, act upon their threatened retaliation at the end of this year.

We would be pleased to respond to any questions that you may have.

Very truly yours,

/s/ Frank D. Kittredge
Frank D. Kittredge
President

SENATE THIRD READING

SB 671 (Alquist) – As Amended: September 9, 1993

SENATE VOTE: 26-8

ASSEMBLY ACTIONS:

COMMITTEE REV. &. TAX VOTE 6-0

COMMITTEE W. & M. VOTE 14-7

Ayes: Horcher, Allen, Costa, Epple, Johnson, Brulte, Lee, Murray, Nolan, O'Connell, Polanco, Quackenbush, Seastrand, Woodruff

Nays: Vasconcellos, Alpert, V. Brown, Burton, Campbell, B. Friedman, Hannigan

DIGEST

Existing law provides for the apportionment of income for firms doing business both within California and outside the state, for deductions against income of certain meals and entertainment expenses, a credit for certain research and development activities, a sales and use tax on the purchase of manufacturing equipment, and various other provisions.

Existing law, income apportionment, provides that for corporations which operate both within California and in other states or nations, the portion of the firm's total income attributable to California is determined by a "three-factor" formula relating the company's payroll, property and sales in California to the total of those factors nationwide or worldwide.

However, a company can make a "water's-edge" election. Under this method, a firm can compute its California

taxable income by reference to its income and apportionment factors from within the "water's-edge" only, rather than worldwide. Essentially, this means foreign business operations are excluded from the calculation.

There are various requirements for companies making the water's-edge election, and the Franchise Tax Board (FTB) has certain authority to enforce these provisions. Specifically, the water's-edge legislation required a firm making the election to: 1) pay an election fee; 2) file a "domestic disclosure spreadsheet" every three years if the firm had property, payroll or sales which exceeded specified amounts; and 3) allow FTB to "disregard" a company's water's-edge election of the FTB determined that the taxpayer willfully refused to provide specified audit information.

This bill:

1) *Income Apportionment.* Makes various changes to California's unitary method of income apportionment, including:

   a) Deletes the requirement to file the domestic disclosure spreadsheet for firms making the water's-edge election, and replaces this requirement with a minimal reporting requirement for firms with over $200 million in assets.

   b) Eliminates FTB's authority to "disregard" a water's-edge election. In place of the disregard authority, the bill requires taxpayers to provide specified audit information. Taxpayers failing to provide that information would be subject to a substantial penalty (in lieu of the current disregard power).

   c) Repeals the election fee for taxpayers filing their return on a water's-edge basis. The repeal is effective for income years beginning on or after January 1, 1994.

2) *Business Meals.* Reduces from 80% to 50% the percentage of business meals and entertainment which may be deducted as an ordinary and necessary expense. This change is consistent with recent federal tax law changes.

3) *Subchapter S.* Reduces from 2.5% to 1.5% the tax rate applied to Subchapter S corporations.

4) *Investment Tax Credit.* Establishes a tax credit equal to 6% of qualified manufacturing equipment placed in service after January 1, 1994. However, the credit could not be claimed prior to a taxpayer's 1995 tax year.

   The credit could only be claimed for manufacturing equipment which is "depreciable" under certain federal tax rules. Additionally, "special purpose buildings and foundations" for certain electronic manufacturers would be eligible for the credit, as would property related to specified biotech engineering activity.

   The credit could be claimed against both the regular tax and the alternative minimum tax, and unused credits could be carried forward for up to 8 years (10 years for "small" firms).

   The credit would sunset January 1, 2001 if manufacturing employment in California (except aerospace employment) does not increase by at least 100,000 between January 1, 1994 and January 1, 2001.

   Additionally, the measure allows a "start-up" firm the option of a 5% sales tax exemption on qualifying manufacturing equipment during its first 3 years of

operation (e.g., a start-up firm could take either the 6% income tax credit or the 5% sales tax exemption). A start-up firm is defined as a firm which begins business after January 1, 1994.

5) *Space Flight Material.* Exempts from the sales and use tax space flight material used in a launch originating at Vandenberg Air Force Base. This exemption sunsets January 1, 2004.

6) *Research and Development Credit.* Deletes the January 1, 1998 sunset date of the research and development tax credit, thereby making the credit permanent. Additionally, the measure replaces the state's "three-year rolling average" method of calculating the credit with the federal "fixed base" method.

7) *Small Business Stock Capital Gains.* Exempts from taxation 50% of the capital gain realized from the sale of a qualified small business stock held for 5 or more years. For a stock to be eligible for this income exclusion, it must meet the following criteria:

   a) Must be originally issued after August 10, 1993 and before December 31, 1998, by a company doing business in California which has less than $50 million in gross assets. At least 80% of the qualifying company's payroll must be attributable to employment located in California.

   b) The issuing company cannot be engaged primarily in the performance of specified services including: health, law, engineering, accounting, performing arts, or consulting. Additionally, firms engaged in banking, insurance, farming, oil and gas extraction, or hotels and restaurants cannot issue qualifying stock.

These criteria are consistent with recent federal tax changes which create a similar capital gains exemption.

FISCAL EFFECT

State: The net effect of estimates provided by FTB, the Board of Equalization and the Governor's office is that this measure would generate revenue losses of approximately $27 million in 1993-94, $92 to $142 million in 1994-95, $368 to $418 million in 1995-96, and $375 to $425 million in 1996-97. The effect of the individual provisions of the bill are summarized in Attachment I.

Local: Annual revenue losses in the range of $1 million due to the bill's exemption for space flight material.

Attachment I

SB 671 (Alquist) Summary of Fiscal Effect
($ in millions)

	1993-94	1994-95	1995-96	1996-97
Repeal Water's-Edge Election Fee	$-15	$-60	$-75	$-80
Research & Development Tax Credit	-22	-45	-50	-60*
Small Business Stock Capital Gains Exemption	---	---	---	---**
6% Investment Tax Credit	---	-50 to -100	-300 to -350	-300 to -350
Reduce Business Meals Deduction	+40	+140	+150	+160
Sales Tax Exemption for Space Flight Property	---	-7	-15	-15
Reduce Subchapter S Tax Rate	-30	-70	-78	-80
Net Fiscal Effect	-27	-92 to -142	-368 to -418	-375 to -425

* Deletion of sunset will increase this loss beginning in 1998-99 by about $150 million and by increasing amounts annually thereafter.

** Revenue losses from capital gains exclusion do not begin until 1998-99 and are in the range of $15 million, increasing to $43 million by 2001-02.

Source: Franchise Tax Board, Board of Equalization, Governor's Office